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SUBJECT: SOFTWOOD LUMBER: COMPANIES URGE RETURN TO TABLE

REF: (A) OTTAWA 311; (B) VANCOUVER 358

¶1. (SBU) Summary: Major Canadian softwood industry officials tell the Embassy that they are pushing the Harper government for a quick restart of lumber negotiations, and advising Canadian officials not to waste time trying to reach full consensus in the industry. The officials understand that B.C., Ontario and Quebec are working with the Canadian government on the parameters of a deal. They would like to see a long-term agreement that would avoid another round of disputes ("Lumber V") -- and expect a solution to the softwood lumber problem to be highly complex. End summary.

¶2. (SBU) On March 24, Charge d'Affaires, Econ Minister-Counselor and Econ Officers met with officials from Weyerhaeuser, Canfor and Abitibi Consolidated (protect), who together represent a significant proportion of the Canadian lumber industry and have operations throughout the West, Ontario and Quebec, as well as in the U.S.. The company executives were in Ottawa to lobby Cabinet ministers in the run up to the March 30-31 Leaders' NAFTA Meeting in Cancun; they told us they are staking their hopes on the POTUS-Harper meeting to kickstart a new lumber negotiation.

Message: Just Do It.  
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¶3. (SBU) The industry officials told us what they are telling Canadian ministers: we have a short window of opportunity, before the November 2006 U.S. Congressional election campaign and a Canadian Parliamentary election which could take place relatively soon, to conduct (in the words of Trade Minister Emerson) "swift and efficient negotiations" to reach a deal. They are encouraged by a perceived moderation in tone among U.S. industry and consumer players at the recent Senate Finance Committee hearings and heartened by the US-Mexico settlement on cement, the other iconic NAFTA trade dispute. Echoing earlier industry comments (reftel), they say that governments should not wait for full industry consensus on either side, and that the time for big industry consultations has passed. Their companies are prepared to step back from day-to-day involvement in talks; in their view, governments should cut a deal and ignore the inevitable opposition from individual firms since no deal will satisfy everyone. In their view the government needs to reach a settlement quickly because it cannot afford a renewed provincial schism among B.C., Ontario and Quebec. They believe the message is falling on receptive ears in Ottawa, although the new Harper government is still struggling with staffing issues.

But Not At Any Cost  
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14. (SBU) Nevertheless, the forest industry officials stressed that there are limits to what industry will accept. Any deal has to recognize the current status quo, factoring in both the stronger Canadian dollar over the past two years and the "legal environment," (the results of the NAFTA dispute settlement process and ongoing litigation) Also, any lumber deal cannot "discriminate against one province" (presumably meaning B.C.). They also suggested (also a recurring theme) that U.S. industry would also have to become more realistic in its expectations for a deal.

#### Where Are the Provinces?

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15. (SBU) In response to a question about provincial politics, the industry executives said that B.C., Ontario and Quebec Premiers Campbell, McGuinty and Charest have been consulting closely and have made a joint approach to the federal government on elements of an acceptable agreement. Alberta, the fourth biggest lumber producer, still hasn't come to the table at the political level but Alberta officials are participating in technical meetings.

16. (SBU) The executives were somewhat defensive about the March 24 announcement by the Province of Quebec of new proposed aid to forest products companies of over 900 million CAD in the next four years. They argued, among other things, that forest operations in the U.S. in some cases receive similar support from state governments. We took the opportunity to remind them that this package, like the previously announced Ontario and federal government assistance packages, made it more difficult to make the case for resolving the issue.

#### Elements of a Deal

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17. With the disclaimer that they have no "specific conclusion" on what a deal should include, the industry representatives floated various thoughts on the key elements of a settlement. First of all, they expect any agreement to be quite complex, given the number of elements in play, but urged governments to avoid trying to "re-construct the forest sector." (Comment: this implies that wholesale changes in stumpage and other provincial practices would be unlikely to be on the table. End Comment) They would like to see a long-term agreement, e.g. at least seven years in duration, in order to allow Canadian firms to adapt to the structural shifts now underway in the industry and the looming effects of beetle kill in B.C. They thought that some of the ideas floated during previous bilateral discussions last November should be revived, such as elements on market share and volume and some kind of a floor price mechanism that would avoid oversupply and wild downswings in price as housing starts fall in the U.S. With regard to market share, one industry representative proposed that any market share percentage should be based on total imports into the U.S. lumber market rather than Canadian imports, giving the Canadians a chance to compete directly against Europeans and other new entrants that have snapped up U.S. market share. On the touchy question of deposits, they only said cautiously that "something could be done." They clearly expect that a "large portion" of the deposits would eventually be returned to Canadian companies. They also repeated the call for a binational panel to oversee the agreement.

#### The Future of the Canadian Forest Industry

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18. (SBU) The industry representatives also offered their thoughts on the future of the Canadian industry. Beetle kill (ref. B) is a critical problem for operations in the B.C. interior; existing mills will increasingly wind up being surrounded by dead trees and the cost of hauling logs from ever-more distant living stands will skyrocket.

Everybody expects the forest products sector to be consolidated into fewer, bigger companies, but with a trend away from integrated forestry operations (because capital demands are "too significant") towards companies concentrating on specific product lines; e.g. spinoffs of pulp production, under pressure from fast-growing Southern Hemisphere imports. For instance, Abitibi is developing a market niche in dealing with recycled paper. Increasingly, Canadian forest producers see a future in the energy sector, possibly replacing lost pulp and paper exports with electricity exports to the U.S. market. (Comment: Ontario's recent announcement that it will pay subsidized rates to alternative energy producers suggests that provincial officials, faced with serious structural adjustment problems in forest communities, are likely to encourage this development. End Comment.)

WILKINS